

Executive Summary

**The Evolvment of the College Wage Premium in the
Israeli Labor Market
Supply and Demand Factors**

Gilad Brand
Milken Institute Fellow

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In addition, Fellows craft their own policy studies during their internship aimed at identifying barriers to job creation and capital formation in Israel. The Fellows' research, carried out under the guidance of an experienced academic and professional staff, support policy makers who shape economic reality in Israel. The program offers the ultimate training opportunity, combining real-life work experience with applied research.

Throughout the year, Fellows receive intensive training in economic and financial analysis, public policy processes, and research methods. They acquire tools for communication and presentation, policy analysis, leadership and project management. The fellows participate in a weekly research workshop where they meet senior economic and government professionals, business leaders, and top academic and financial practitioners from Israel and abroad. They also participate in an accredited MBA course. The course, which focuses on financial and economic innovations, is taught at the Hebrew University School of Business Administration by Prof. Glenn Yago (Senior Director/Senior Fellow at the Milken Institute).

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Contact us: info@mifellows.org

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One of the great achievements of the Israeli education system is the dramatic increase in applicants for higher education in the 1990's. By the beginning of the 2000s, Israel had educated its youth at a faster rate than did many other developed countries. Yet in contrast to theories of human capital, the rise in education rates was not followed by a narrowing of the economic gaps that exist in a comparison of the Israeli economy and other developed countries.

In order to explore the roots of this paradox, this research examines the possibility that educational attainment has exceeded the labor market's demand for skill.

By dividing the labor market into tradable and non-tradable components, the full research (Hebrew, 2013), shows that the increase in education was associated with higher productivity only on the tradable side of the labor market, consisting of no more than 20% of the labor force. Following this decomposition method and with the use of the International Standard Classification of Occupations, the study compares the growth rate of workers with higher education to the rise in occupations which require such education. While on the tradable side these two variables tend to move together, in non-tradable industries, the latter is growing at a pace three times faster than the former. This is a strong indication that on the non-tradable side of the economy supply of educated workers has risen faster than demand.

Applying the Katz & Murphy (1992) framework, we examine the supply and demand for skill over the years 1997–2011. A key measure in this framework is the college wage premium which represents the market price of higher education. It is assumed that skill-biased technological changes lead to a steady rise in the demand for skill (Goldin & Katz, 2008). In particular, when supply grows faster than the rate of skill-biased technological change (demand for skill), the college wage premium will fall. When the supply growth falls short of this rate, the skill premium will increase. We find that although the supply of educated workers has increased significantly across all segments of the labor market, the college wage premium has taken a much less uniform course. On the tradable side, demand has increased far more than supply, resulting in a sharp rise in the college wage premium. On the non-tradable side, the premium has reached a near standstill, implying that the supply of educated workers has not exceeded the demand.

Since value added per employee in the non-tradable industries has mostly stagnated over the course of the examined period, and the rise in occupations which require higher education is lagging behind the supply of skill, it is possible that the rise in education has perhaps resulted only in a more selective hiring standard, regardless of the lack of creation of better job prospects.

The findings of this report also shed light on the rapid rise in wage dispersion. It is commonly assumed that skill biased technological change is a major cause of the rise in income inequality (Goldin and Katz 2008). The findings show that this is the case only among the tradable industries consisting of a relative minor fraction of the educated work force. On average, technological advancements did not result in a growing reward for skill for the workers in the non-tradable industries .

In light of this research, policymakers must be proactive in creating better employment opportunities for a larger share of the growing educated workforce. If they fail at that objective, continued increases in income inequality and low value added jobs for a growing share of the educated will result.

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Milken Institute Fellows Program
4 Washington St.
Jerusalem, 9418704, Israel

info@mifellows.org
www.mifellows.org